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No. 03-932

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

DURA PHARMACEUTICALS, INC.; CAM L. GARNER; JAMES W. NEWMAN; CHARLES W. PRETTYMAN; WALTER F. SPATH; JAMES C. BLAIR; JULIA R. BROWN; JOSEPH C. COOK, JR.; and MITCHELL R. WOODBURY,

Petitioners,

v.

MICHAEL BROUDO; BALDEV S. GILL; LARRY MORGAN IRA; LEONID SHVARTSMAN, (for G&S partnership); NEIL SISKIND; ROBERTA SPECK; BRENT VOGT, on behalf of themselves and all others similarly situated,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF

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STATEMENT PURSUANT TO RULE 29.6

Petitioners' corporate disclosure statement was set forth at page *ii* of the Petition for a Writ of Certiorari, and there are no amendments to that statement.

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Whether loss causation can be pleaded and proven in a securities fraud class action absent a causal connection between the alleged fraud and a corresponding decline in share value is solely a question of law, and one which has divided the circuits. Tellingly, respondents' suggestion that no meaningful conflict exits among the circuits is a viewpoint shared by no one else, and is flatly contradicted by the Ninth Circuit in its opinion below.

As all securities litigation practitioners other than respondents acknowledge, the issue of loss causation is the one significant issue defining the scope of claims brought under Section 10(b), which remains to be resolved by this Court. This Court has decided who can be a plaintiff (*Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975)), who can be a defendant (*Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994)), and the standard for wrongdoing (*Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976)). The Court has also decided whether, in the context of a fraud-on-the-market case, there is an individual reliance requirement (*Basic Inc. v. Levinson*, 485 U.S. 224 (1988)). The proper standard for loss causation, however, has been an open conflict for at least six years now. To delay resolution of this issue will simply postpone the inevitable, and ensure that a significant number of interim decisions by lower courts crowded with securities cases are wrongly decided. Because the issue is as ripe and ready as it will ever be, review at this time is appropriate.

The Ninth Circuit here held "in a fraud-on-the-market case, plaintiffs establish loss causation if they have shown that the price *on the date of purchase* was inflated because of the misrepresentation. . . . [I]t is not necessary that a disclosure and subsequent drop in the market price of the

stock have actually occurred. . . ." (Pet. App. 9a; emphasis in original) (citations and internal quotations omitted). It is sophistry for respondents to say this case presents only an intra-Ninth Circuit conflict. As the Ninth Circuit held in the decision below: "By contrast, *other* circuits . . . do require demonstration of a corrective disclosure followed by a stock price drop to be alleged in the complaint." (Pet. App. 9a n.4; emphasis added). Indeed, this conflict has been expressly and judicially acknowledged for over six years.

Similarly, no one other than respondents has suggested that whether the law requires a price drop is dependent on the facts of a given case, nor that there is a different standard for pleading loss causation and proving loss causation. Nor can the meaningful application of the rule to this case be doubted. When it was applied by the district court below, this case was dismissed. Respondents' belated reliance on the November 3, 1998 price decline contradicts their complaint and class allegations and thus provides no basis to avoid the conflict. Notwithstanding respondents' efforts to obfuscate both the existence of the conflict among the circuits and the authorities governing loss causation, the conflict is real, persistent, and well-positioned for resolution by this Court.

I. The Circuit Courts Expressly Acknowledge The Loss Causation Conflict

At least six years ago, the Eleventh Circuit expressly acknowledged the fundamental differences among certain circuits regarding the loss causation requirement. *See Robbins v. Kroger Properties, Inc.*, 116 F.3d 1441, 1448 (11th Cir. 1997):

> some courts have held that '[i]n a fraud-on-the-market case, plaintiffs establish loss causation if they have shown that the price on the date of purchase was inflated because of the misrepresentation.' [citations omitted] . . . Our cases have not utilized the [fraud-on-the-market] theory to alter the loss causation requirement, and we refuse to do so here.

In expressly rejecting interpretations adopted in both the Eighth and Ninth Circuits, the court in *Robbins* held that as a matter of law loss causation could not be established by simply showing that a defendant's misrepresentations resulted in artificially inflated stock prices during the class period. *Id.* at 1448 (citing *Knapp v. Ernst & Whinney*, 90 F.3d 1431, 1438 (9th Cir. 1996) and *In Re Control Data Corp. Securities Litigation*, 933 F.2d 616, 619-20 (8th Cir. 1991)). Instead, a plaintiff is explicitly required to plead and prove a causal connection between the misrepresentation and the investment's subsequent decline in value. *Id.* at 1448.[1]

Similarly, the holding of the Third Circuit in *Semerenko v. Cendant Corp.*, 223 F.3d 165 (3d Cir. 2000) confirms the existing conflict. Agreeing with the Eleventh Circuit's decision in *Robbins*, the court explained: "we are persuaded that an investor *must also establish that the alleged misrepresentations proximately caused the decline in the security's value* to satisfy the element of loss causation." *Id.* at 185 (emphasis added). This holding cannot be reconciled with that of the Ninth Circuit, which very clearly

1. Respondents' attempt to establish agreement among the circuits by reference to the "out-of-pocket loss" rule is not only confusing, but misplaced. (Opp. at 7) As the Eleventh Circuit noted in *Robbins*: "Proof of damages under the out-of-pocket rule is not proof of loss causation. Our cases have repeatedly treated loss causation and damages as involving discrete inquiries." *Robbins*, 116 F.3d at 1447 n.5.

prescribes: "it is not necessary that a . . . subsequent drop in the market price of the stock have actually occurred. . . ." (Pet. App. 9a)

The fact that Dura's share price declined somewhat following the Company's November 3, 1998 announcement does not render the Third Circuit's holding consistent with the Ninth Circuit's holding in this case. Unlike the plaintiffs in *Semerenko*, respondents here are not seeking to recover losses in connection with the price decline following the November 3 announcement concerning Albuterol Spiros. This is discussed at length, *infra*, at II. Instead, as both lower courts recognized, respondents are seeking to recover losses associated with an earlier February 25, 1998 price decline, which is not associated with any corrective disclosure regarding Albuterol Spiros. The Ninth Circuit's holding made absolutely no connection between the Albuterol Spiros allegations and the November 3, 1998 price decline. In this respect, the Ninth Circuit's holding is diametrically opposed to that of the Third Circuit in *Semerenko*.[2]

2. Respondents' reliance on the Third Circuit's decision in *EP Medsystems, Inc. v. Echocath, Inc.*, 235 F.3d 865 (3d Cir. 2000) is unfounded. Unlike this case, *EP Medsystems* was not a fraud-on-the-market case. Rather, it was an individual investor case and was not based on public misrepresentations or omissions that affected the price of the stock it purchased. As the court there explained "this action is more akin to a contract action than a securities action . . . ." *Id.* at 871. Notably, that court specifically explained that in considering loss causation, it was important to recognize that there were significant distinctions between this case and the usual securities case. *Id.* at 884. As the court stated: "None of the cases in this circuit is analogous. . . . although we take guidance from the language in other cases, . . . the holdings are to some extent inapplicable here." *Id.*

Further judicial acknowledgment of the significance of this conflict was articulated only six weeks ago. *See In re Initial Public Offering Sec. Litig.*, 2003 WL 23096875 *1 (S.D.N.Y. Dec. 31, 2003) (the issue of whether bare allegations of artificial price inflation at the time of purchase are sufficient to plead loss causation under the fraud on the market theory "highlights an important circuit split in the pleading of securities fraud."). In analyzing the conflict, the district court explained: "The Courts of Appeal are deeply divided on this question. The Eighth and Ninth Circuits have recently reaffirmed their holding that allegations of artificial inflation, alone, *are* sufficient.[3] The Third and the Eleventh circuits have held otherwise." *Id.* at *2 (emphasis in original).[4]

In self-serving fashion, respondents now contend that the conflict among the circuits is insignificant — a marked departure from the position respondents articulated before the Ninth Circuit. In arguing below that the district court's ruling on loss causation was wrong, respondents asserted that "Under this [Ninth] Circuit's law . . . [t]he correct focus is on the stock's inflation at the moment of purchase — not on

3. Citing in a footnote to this case, *Broudo v. Dura Pharmaceuticals, Inc.*, 339 F.3d 933, 938 (9th Cir. 2003), and *Gebhardt v. ConAgra Foods, Inc.*, 335 F.3d 824, 831 (8th Cir. 2003).

4. The fact that various circuits commonly invoke *Huddleston v. Herman & MacLean*, 640 F.2d 534 (5th Cir. 1981) in their analysis of loss causation does not negate the existing conflict. *Huddleston* merely sets forth that loss causation is a requirement in Rule 10b-5 cases; unlike the Third, Eleventh and Second Circuits, as well as the Eighth and Ninth, the Fifth Circuit in *Huddleston* did not consider whether bare allegations and proof of price inflation would, without more, be sufficient to satisfy loss causation.

its price at some later time." (Plaintiffs-Appellants Opening Brief at 18). Respondents even criticized the district court's reliance on *Robbins*, arguing that "in this Circuit, *Robbins* does not control." (Plaintiffs-Appellants Opening Brief at 20). Now, however, respondents assert that the price decline following the November 3, 1998 announcement is relevant to the loss causation analysis here. They also assert that *Robbins* is consistent with prior Ninth Circuit precedent. As discussed in further detail below, respondents' changes in position are unavailing.

The conflict among the circuits regarding the rule of loss causation has been recognized by circuit courts, district courts and commentators alike. Indeed, it has even been acknowledged by respondents in their filings below. Respondents' assertion that the differences among the circuits is more a matter of semantics than substantive legal principles is simply wrong.[5] In addition, respondents' suggestion that whether the law requires causation of a stock price decline is something that may vary from case to case is barren of any judicial support. Loss causation is a rule of law that is deserving of uniform and consistent application among the circuits.

5. Respondents' attempt to dismiss as "obiter dictum" the Second Circuit's analysis in *Emergent Capital Investment Management, LLC v. Stonepath Group, Inc.*, 343 F.3d 189 (2d Cir. 2003) regarding the loss causation standard and its prior holding in *Suez Equity Investors L.P. v. Toronto-Dominion Bank*, 250 F.3d 87 (2d Cir. 2001) is similarly misguided. (Opp. at 11). The court in *Emergent Capital* found that the lower court's reliance on the previous holding in *Suez Equity* was misplaced in that the lower court misinterpreted *Suez Equity*. The Second Circuit's analysis and clarification in this regard amounts to a measured judicial pronouncement regarding the loss causation standard in the Second Circuit and, as such, is not dicta. (*See United States v. Crawley*, 837 F.2d 291, 292-93 (7th Cir. 1988)).

II. Resolution Of The Loss Causation Issue Has A Dispositive Impact In This Case And Is Of Fundamental Importance To Numerous Pending Securities Cases

For the first time, respondents argue that the November 3, 1998 price decline — nine months after the February 24, 1998 termination of the Class Period — is somehow relevant to establishing loss causation in this case. This is a remarkably novel proposition and 180 degree turn by respondents, for nowhere in the operative Second Amended Complaint do they so much as allege the November 3, 1998 price decline. Similarly, respondents did not address the November 3 price decline anywhere in their opposition to defendants' motion to dismiss plaintiffs' Second Amended Complaint. In fact, the only mention respondents make of this price decline is a cursory reference to it in their Opening Brief to the Ninth Circuit. (Plaintiffs-Appellants' Opening Brief at 21). Even then, respondents did not argue that it was a loss for which they ought to recover, nor did they assert it as a basis for establishing loss causation.

Respondents' sudden shift in position does not comport with the action they filed, and, in any event, should not be tolerated. As this Court recently reiterated, where "a party assumes a certain position in a legal proceeding, and succeeds in maintaining that position, he may not thereafter, simply because his interests have changed, assume a contrary position." *New Hampshire v. Maine*, 532 U.S. 742, 749 (2001), *quoting Davis v. Wakelee*, 156 U.S. 680, 689 (1895). This rule serves the "integrity of the judicial process" by preventing parties from "playing fast and loose with the courts" based on the "exigencies of the moment." *Id.* (citations and internal quotations omitted).

The fact is, the November 3, 1998 price decline is irrelevant to respondents' claims. As required by the Reform Act, a plaintiff who brings a securities fraud claim "shall have the burden of proving that the act or omission of the defendant alleged to violate [the Exchange Act] *caused the loss for which the plaintiff seeks to recover damages*." 15 U.S.C. § 78u-4(b)(4) (emphasis added) (reproduced at Pet. App. 54a). As the cases discussed herein make clear, this requirement applies equally at both the pleading and proof stages. Respondents' Class Period ends on February 24, 1998. The "loss" for which respondents seek to recover here is that associated with the 47% price decline that occurred between February 24, 1998 and February 25, 1998. The abbreviated November 3, 1998 price decline — ninth months later — is not part of this equation. Respondents have not claimed — nor do they claim here — that they are seeking to recover for any loss that occurred on November 3, 1998.[6]

Accordingly, this Court's resolution of the question presented will be dispositive of respondents' Albuterol Spiros claims in this case. The proper standard for loss causation is a question of law, which can be (and indeed should be) addressed at the Rule 12(b)(6) stage. Should this Court reject the standard applied by the Ninth Circuit and adopt an interpretation similar to that applied in the Eleventh, Third and now Second Circuits, respondents' claims regarding Albuterol Spiros will be dismissed, just as the district court did below.

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6. Respondents presumably did not seek to recover losses associated with the November 3, 1998 price decline because within twelve trading days, the stock price had recovered, and within ninety days it closed $1.625 higher than it was prior to the November 3 announcement. Not surprisingly, respondents strategically elected to end their Class Period on February 24, 1998, with the 47% price decline, and not nine months later, with the temporary 21% price decline, where the shares immediately rebounded. (Petition at 15-19).

Resolution of the question presented will also have an impact far beyond this case. There are currently hundreds of securities cases making their way through the federal court pipeline that are affected by the loss causation conflict. *See* Motion For Leave To File A Brief As *Amicus Curiae* and Brief for the Securities Industry Association as *Amicus Curiae* in Support of Petitioners at 5. A uniform rule on loss causation is, therefore, important to prevent even more cases from being wrongly decided.

III. Petitioners Did Not Raise The Reform Act's "Look Back" Provision As A New Issue

Petitioners did not raise the Reform Act's "look back" provision as a new issue, nor do petitioners suggest that this provision will resolve the existing conflict regarding loss causation. Rather, petitioners raise the "look back" provision as a tangible illustration of how the Ninth Circuit's rule does not comport with the overall statutory scheme of the Reform Act. As exemplified by the "look back" provision, its measure of damages or "loss" is applied at the conclusion of the class period and in connection with a contemporaneous stock price decline, and is not measured by the stock's behavior at some unspecified later time which is bereft of any nexus to the class period.

CONCLUSION

This Court should grant the petition for certiorari.

Respectfully submitted,

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